

## THE PHASEINVESTING® SOLUTION

### The Art of Next Generation Absolute Return Investing

#### HELPING YOU TO DELIVER PERFORMANCE

Different investment products work best in different market environments. Therefore, for generations, investors have pondered the questions: “**Which investment, when?**” and then “**How to combine investments to form effective investment portfolio?**” Phaseinvesting provides a solution.

Phaseinvesting is a portfolio-based, absolute return strategy. Depending on the market phase, it taps the appropriate investment products ranging from index products to alternative investments, using an innovative behavioural-based framework to achieve its objective of positive returns in different market environments. Unlike other investment approaches, phaseinvesting concentrates on actively dealing with the dynamics of market phases, and not on “timing”, forecasting markets, or on static selection or arbitrarily broad diversification as is typically the practice. The dynamics of market phases is built into the structure of the portfolio, exposing investors to the right return sources at the most appropriate time. **Hedge fund-of-funds investing** is a sub-set of the broader phaseinvesting asset allocation approach.

#### ACTIVELY DEAL WITH THE DYNAMICS OF MARKET PHASES

Markets transition through different market phases. Not only do these phases possess their own return / risk profile, but different investments tend to perform well in different market phases. Therefore, in order to maximize returns, while avoiding unwanted risk, phaseinvesting deals with the dynamics of markets.

Capitalizing on new insights in financial market theory, phaseinvesting actively integrates the current market “mood”, “environment” or “phase” into the structure of the portfolio by investing in investment products that share the same underlying behavioral drivers as the prevailing market phase. This alignment of investment opportunities and market phases is referred to as “acclimatization”. In the same way that the weather or climate determines what we wear or how we dress, the market environment or “phase” should dictate investment selection and the overall structure of an investment portfolio. As the market evolves from one phase to another, so too should the structure of the portfolio.

New to this process is the idea that one can tilt the odds of investment success by not forecasting, but by systematically managing the structure and composition of the investment portfolio through a **stringent and disciplined multi-style alignment process**. Note that the focus is not on the type of asset classes being applied (stocks, bonds or cash), but rather on “how” returns are being generated, i.e. on the investment style being applied.

#### THE POWER OF MULTI-STYLE ALIGNMENT

The phaseinvesting multi-style alignment process matches the appropriate **investment styles** to the prevailing **market phase** with the help of insights from a new behavioural-based price theory.

For example, the theory tells us that there are so-called **learning market phases**. These market phases are characterized by trending price patterns, which result from investor *learning*. As investors “learn”, i.e. as they catch on to new ideas and opportunities, and then act to take advantage of them, their actions will bring about trending price movements.

There are also **discovery market phases**. These are market phases which are characterized by sideways price movement. Differing investor opinion, investor anxiety and uncertainty, generally dominate during discovery phases.

In order to best exploit given market opportunities, while minimizing exposure to unwanted risks, phaseinvesting portfolios focus on “learning” styles during “learning” market phases, while emphasizing “discovery” styles during

“discovery” market phases. As illustrated below by the monthly returns of a composite index of learning styles and discovery styles, the two categories of styles exhibit characteristically different return/risk properties. The Learning Style Index (Figure 1a) produces higher, but more volatile monthly returns—exactly what one would want when markets are trending. Meanwhile the Discovery Style Index (Figure 1b) produces stable and more constant returns—exactly the defensive nature that one would require when markets are more treacherous.

Figure 1a: Monthly Returns of the Learning Style Index

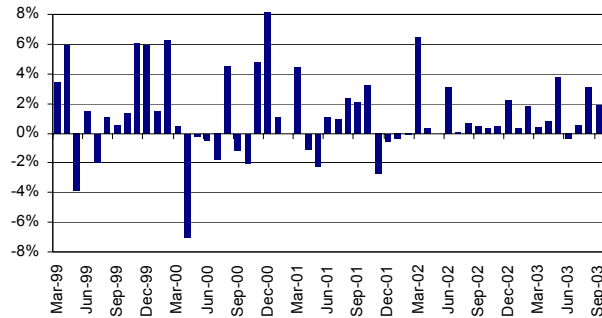
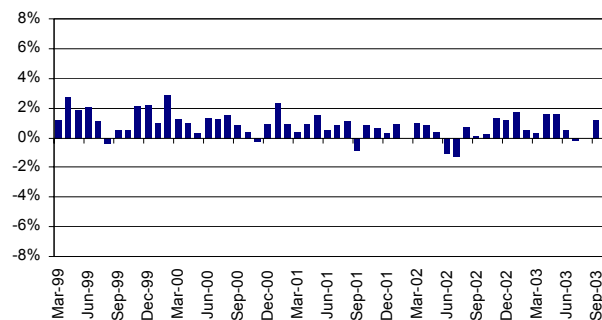
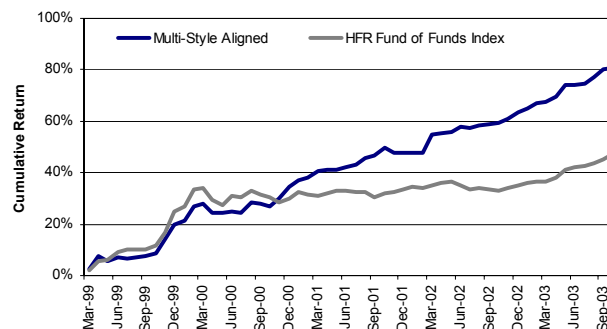


Figure 1b: Monthly Returns of the Discovery Style Index



The application of a simple style-to-market-phase alignment process, in combination with certain diversification constraints, produced over the period March 1999 to October 2003 **an annualized return of 13.5% with 5.8% volatility** (Cumulative return = 80.6%). Compare these results to that of the HFRI hedge fund-of-funds index which produced an annualized return of 8.6% with 5.9% volatility (Cumulative return = 47.2%). The phaseinvesting multi-style aligned portfolio outperformed the HFRI index by nearly 500 basis points with the same level of risk! This illustrates the power of acclimatization and the multi-style alignment process.

Figure 2: The Power of Multi-Style Alignment



## PHASEINVESTING® ADVISORY SERVICES

Phaseinvesting advisory programs are generally customized to clients needs. All advisory programs can be repackaged as *funds*, *certificates*, *principal-protected notes*, *warrants* etc. and *can be white-labeled*. All

programs are geared to meet the requirements of the German Investment Modernization Act. Here are examples of programs that are currently available:

#### ▶ Phaseinvesting® Multi-Product Program

True to its name, the Phaseinvesting® Multi-Product Program is a multi-product-based, absolute return program that integrates a range of products and vehicles—from tradition index products to mutual funds, to hedge funds and hedge fund style indices—all depending on the prevailing market phase. Think of this program as being a “total” asset allocation product. Its sources of added value range from proper phase allocation, style allocation to manager/product selection. (A monthly one-page performance report is available upon request.)

#### ▶ Phaseinvesting® with Style Program

The Phaseinvesting® with Style Program provides pure alternative investment exposure. It was designed to be an effective alternative to traditional hedge fund-of-funds. The program combines the phaseinvesting technology with the HFRX family of investable hedge fund style indices. The objective here: simply to get the style allocation right, and right on a timely basis. In the past, this kind of focus has generated significant outperformance versus the average hedge fund-of-funds. (A monthly one-page performance report is available upon request.)

Recently, there have been requests for a **Phaseinvesting® Hedge Fund-of-Funds Program**. This program would tailor a hedge fund-of-funds program for institutions, taking into account the requirements of the Investment Modernization Act, while drawing on our hedge fund know-how and style allocation expertise.

### COMMON CHARACTERISTICS OF PHASEINVESTING ADVISORY PROGRAMS

Common to all phaseinvesting advisory programs are a set of minimum standards:

- ▶ Absolute return oriented
- ▶ Goal of consistent and steady performance
- ▶ Acclimatized portfolio structure
- ▶ Attractive risk/return profile
- ▶ Low correlation to traditional stock and bond markets
- ▶ Dynamic exposure to markets, depending on the market situation
- ▶ Effective diversification across different return drivers to protect against correlation breakdown and tail risks, thus providing true risk reduction benefits
- ▶ Disciplined approach to style allocation
- ▶ Attractive liquidity conditions
- ▶ Safety: No direct investments into hedge funds. Use managed account platforms which separates custody from trading advisors, and provides transparency of underlying positions
- ▶ Risk monitoring and compliance in collaboration with a team of excellent partners. Two of the most prominent partners are Deutsche Bank AG and Hedge Fund Research, Inc. (HFR)

### PHASEINVESTING TECHNOLOGIES, INC.

PhaseInvesting Technologies, Inc. is an independent investment advisory and consulting organization specializing in the German and Swiss market. Our approach to constructing absolute return portfolios represents a radical intellectual departure from traditional practices, delivering investors and product vendors alike, unique and uncompromising portfolio-related solutions. For more information, visit our website at [www.phaseinvesting.com](http://www.phaseinvesting.com) or contact our local representative at: PhaseInvesting Technologies, Inc., European Representative Office, Frankfurter Welle, An der Welle 4, 60422 Frankfurt am Main, Germany, +49 (0)69 7593 8455, [ksato@phaseinvesting.com](mailto:ksato@phaseinvesting.com)